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IN THE

Supreme Court of the United States

OCTOBER TERM, 1957

JOHNSON FARE BOX COMPANY,
Petitioner,
against
LESTER T. DOYLE, Trustee in Reorganization of THIRD AVENUE TRANSIT CORPORATION, Debtor,
SURFACE TRANSPORTATION CORPORATION OF NEW YORK, Debtor,
WESTCHESTER STREET TRANSPORTATION COMPANY, Debtor,
THE WESTCHESTER ELECTRIC RAILROAD COMPANY, Debtor,
THE YONKERS RAILROAD COMPANY, Debtor, and
WARONTAS PRESS, INC., Debtor,
Respondents.

No. 1045

REPLY BRIEF OF JOHNSON FARE BOX CO. IN SUPPORT OF PETITION FOR CERTIORARI

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INDEX

PAGE

Preliminary Statement 1

Point I—In reply to the argument of the trustee that there is no conflict with the decisions of this Court, as made on pages 9-11 of the trustee's brief 2

Point II—In reply to the trustee's argument that there is no conflict between the Second and Fourth Circuits 3

Point III—In reply to the trustee's argument that the decision of the Court below is correct 5

Point IV—The six months' rule is a recognized exception to the "absolute priority" which mortgagees would otherwise enjoy 10

Conclusion 11

PAGE

CASES CITED

Burnham v. *Bowen*, 111 U. S. 776 2

Continental Trust Co. v. *Bonsal*, 72 F. (2d) 975, cert. den. 293 U. S. 624 .....3, 4, 5
Crane v. *Fidelity Trust Co.*, 238 Fed. 693 ..... 9, 10

Fosdick v. *Schall*, 99 U. S. 235 .....2, 3, 8

Kneeland v. *American Loan Co.*, 136 U. S. 89 11

Lackawanna Iron & Coal Co. v. *Farmers Loan & Trust Co.*, 176 U. S. 298 ..... 7, 8

Rodger Ballast Car Co. v. *Omaha K. C. & E. R. Co.*, 154 Fed. 629 9

Southern Railway Co. v. *Carnegie Steel Co.*, 176 U. S. 257 .....2, 3, 7, 8, 10, 11

Union Switch & Signal Co. v. *Powell*, 84 F. (2d) 25..3, 4, 5

Virginia Passenger & Power Co. v. *Lane Bros. Co.*, 174 Fed. 513, cert. den. 215 U. S. 610 .....3, 4, 5

MISCELLANEOUS

FitzGibbons "The Present Status of the Six Months' Rule", 34 Col. L. Review 6

2 Gèrdes on Corporate Reorganization 8

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Preliminary Statement

A large portion of the respondents' brief deals with its contention that, as it states, the decision below "is patently correct" (pp. 5, *et seq.*). Although we shall briefly deal herein with its contention in this regard, we

emphasize that the main issue, upon this Application for Certiorari, is our claim that the decision of the Court below is in conflict with the Supreme Court decisions of *Fosdick* v. *Schall*, 99 U. S. 235, and *Southern Railway Co.* v. *Carnegie Steel Co.*, 176 U. S. 257, as well as other decisions, and, further, that there is a conflict of decisions between the Second Circuit and the Fourth Circuit.

We, therefore, deal first with respondents' contention that "there is no conflict with *Fosdick* v. *Schall* and *Southern Railway Co.* v. *Carnegie Steel Co.*" (pp. 9, *et seq.*)

POINT I

In reply to the argument of the trustee that there is no conflict with the decisions of this Court, as made on pages 9-11 of the trustee's brief.

The trustee does not deny that the language of *Fosdick* v. *Schall, supra*, clearly includes within the six months' rule claims relating to "equipment" and "useful improvements". He contends, however, that this language is purely *dictum*, and then makes the remarkable and gratuitous assertion that *it has never since been followed* by this Court. In this connection, he wholly ignores some of *this* Court's leading decisions on this subject. Thus, in *Burnham* v. *Bowen*, 111 U. S. 776, this Court stated:

> "As was said in *Fosdick* v. *Schall*, 99 U. S. 252, 'The income [of a railroad company] out of which the mortgagee is to be paid, is the net income obtained by deducting from the gross earnings what is required for necessary operating and managing expenses, *proper equipment and useful improvements.*' " (Emphasis supplied)

Later, in *Southern Railway Co.* v. *Carnegie Steel Co.*, 176 U. S. 257, decided many years after *Fosdick* v. *Schall*, this Court granted priority to a claim for steel rails and

not only relied upon the *Fosdick* case, but at several places in the opinion quoted the very language which refers to "eqipment" and "useful improvements".

The trustee further ignores that this Court was asked to review the decisions in both *Continental Trust Co.* v. *Bonsal*, 72 F. (2d) 975, and *Virginia Passenger & Power Co.* v. *Lane Bros. Co.*, 174 Fed. 513, in the Fourth Circuit, and that certiorari was denied in both instances (293 U. S. 624; 215 U. S. 610).

The trustee, at page 10, attempts to distinguish the decision of this Court in *Southern Railway Co.* v. *Carnegie Steel Co., supra*, by stating that it involved only a small quantity of rails, whereas in the case at bar the claim is allegedly "extraordinary". The fact is that that in *Southern Railway Co.*, where priority was granted by this Court, 4,450 tons of rails had been furnished and the claim, plus interest, aggregated more than $150,000; in the case at bar where, so far, priority has been denied, the claim is only for $43,491. It involved the purchase of 225 fare boxes which, it must be recognized, are physically but a small part of a bus, and their cost in relation to that of the bus was inconsequential. The claim, therefore, is in no sense large or extraordinary considering the extensive transportation system here involved.

POINT II

In reply to the trustee's argument that there is no conflict between the Second and Fourth Circuits.

The trustee contends that the decisions of the Fourth Circuit in *Virginia Passenger & Power Co.* v. *Lane Bros. Co.*, 174 F. 513, and *Continental Trust Co.* v. *W. R. Bonsal & Co.*, 72 F. (2d) 975, relied upon by Johnson to show conflict with the Second Circuit, were "effectively overruled" by the Fourth Circuit in the case of *Union Switch & Signal Co.* v. *Powell*, 84 F. (2d) 25. The fact is that

that decision not only did not reverse the *Virginia* case, but did not even mention it. As to the *Continental* case, far from reversing it, the Court expressly approved it, and stated (p. 26):

> "We think that the action of the lower Court with respect to the first two claims is clearly in accord with the principles which we laid down in Continental Trust Co. v. W. R. Bonsal & Co. (C.C.A. 4th) 72 F. (2d) 975, 981, wherein we carefully reviewed the law and stated the rules applicable in cases of this character."

In the *Union Switch & Signal Co.* case, the Court held that the following items did not come within the six months' rule:

1. Remote control switches, costing over $11,000 per piece, to replace hand switches which cost $1,000 each;
2. Installation of an interlocking plant at a point where there had never been one before;
3. Purchase of signal supplies and construction of additional track, although the tracks were not, in fact, constructed and the equipment was later used for operations.

As to the third group of items, the Court pointed out that even though, because of the abandonment of the plan for additional track, the signal equipment was stored and presumably used for maintenance or operating purposes, that fact "did not change the character of the materials from new construction materials to ordinary and necessary operating supplies".

The Court of Appeals quoted from the opinion of the District Court as follows:

> "The District Court affirmed the finding as to all of these matters saying with respect to the third claim:

'it is essential that the consideration for the debt be a current expense of ordinary operation of the railroad necessarily incurred to keep the railroad a going concern. Materials purchased for *new construction, as occurred here,* do not fall in that class'."

Thus, the *Union Switch & Signal Co.* case in the Fourth Circuit did not expressly or by implication overrule that Court's earlier decisions in *Virginia Passenger & Power Co.* and *Continental Trust Co.*, which remain in clear and sharp conflict with the decision of the Second Circuit in the case at bar and require the review of this Court. As heretofore noted, this Court denied certiorari in the *Virginia* and *Continental* cases at 215 U. S. 610 and 293 U. S. 624.

POINT III

In reply to the trustee's argument that the decision of the Court below is correct.

As heretofore stated, the main question on this application for certiorari is whether or not the decision of the Court below is in conflict with decisions of the Supreme Court and of the Fourth Circuit. However, as the trustee has seen fit to discuss in some detail the merits of the case, we make the following short response thereto. Of course, we argued this matter at some length in our petition.

The Reorganization Trustee (respondent) nowhere disputes that:

(a) the claim of Johnson was a current liability contracted with the expectation of the supplier that it was to be paid out of current earnings;

(b) the boxes were intended for and were used in the ordinary operations of the company, were used in old buses to replace boxes which had become

obsolete with an increase in the fare, and did not involve an extension of the transportation system;

(c) the new boxes became subject to the existing mortgage and enured to the benefit of the mortgagee holders; and

(d) the substitution of new boxes for the old ones was found by the District Court to be "*imperative*".

Nor does he dispute that in August, 1949, shortly after the appointment of the original reorganization trustees, without prior approval of the District Court, they accepted delivery of twenty-five of the boxes formerly ordered by Surface; and then, on September 7, 1949, they petitioned the Court for authority to purchase 449 additional boxes at a cost of $111,060.98. That petition expressly stated that both the trustees and the operating officers of the debtors believed that it was "*necessary*" to obtain the additional boxes (Appendix, page 25a, paragraph numbered 10). The significance of this is fully set out in the Petition for Certiorari herein at pages 14 to 17.

The trustee now suggests (footnote p. 2 of Answering Brief) that the new boxes were merely "desirable" and not really necessary. In the light of the finding of the District Court that the new boxes were "imperative" and in view of the admission of the trustees themselves in their application for permission to purchase additional boxes that such boxes were "necessary", the present suggestion of the trustee should be rejected as clearly without foundation or merit.

At pages 6-7, the trustee quotes at length from an article by FitzGibbon on "The Present Status of the Six Months' Rule", wherein the rule formulated by Cutcheon and urged by the trustee is set forth. It should be observed, however, that FitzGibbon makes the following addi-

tional statement:

> "This excellent statement [the Cutcheon statement] may not be immediately appreciated by one who is told that under it, at the same term of the Supreme Court, a claim for steel rails furnished to one railroad company has been held to be entitled to priority (176 U. S. 257) and, in another railroad receivership, a similar claim was denied priority (176 U. S. 298). The answer lies in the fact that in the second case it was found that there were not present the three following prerequisites which are universally recognized as necessary to establish a right to preference:
>
> (1) That the origin for the claim was a 'current expense' of ordinary operation on the railroad necessarily incurred to keep it a going concern.
>
> (2) That the claim represented a debt contracted with the expectation or intention of the parties that it was to be paid out of the 'current earnings' of the railroad.
>
> (3) That the claim accrued within a reasonably brief time (generally construed to be six months) prior to the appointment of the receiver."

In our Petition we have already demonstrated that these three prerequisites are present in the case at bar.

The above statement by FitzGibbon merits further consideration. It will be noted that he refers to two cases, 176 U. S. 257 and 176 U. S. 298, which respectively are *Southern Railway Co.* v. *Carnegie Steel Co.* and *Lackawanna Iron & Coal Co.* v. *Farmers Loan & Trust Co.* As the report shows, these cases immediately followed one another in 176 U. S. In the *Southern Railway* case a claim for steel rails was held to be entitled to priority and in the case immediately following, another claim for steel rails in a substantially larger amount and which did not

provide for short term credit, was denied priority. In the later case (*Lackawanna*), the rails were delivered "about 16 months before the company's property was put into the hands of a receiver, and 5½ years before the appointment of a receiver in this cause." In the *Lackawanna* case, moreover, collateral security had been given by the raiway to the claimant. The quantity of the rails purchased in the *Lackawanna* case was a fundamental basis in the determination that new construction was involved. Of the utmost significance is the fact that it was the *Southern Railway Company* case, quoted on page 9 of the Petition, in which this Court explicitly included "proper *equipment*" and "*useful improvements*" as coming within the scope of the six months' rule. It is hardly conceivable that this same Court, which on the same day decided the *Lackawanna Iron & Coal Co.* case, should have ignored or overruled its definition made in *Southern Railway Co.* case, which in turn was quoting *Fosdick* v. *Schall*, 99 U. S. 235. Yet it is significant that FitzGibbon, in the article quoted above, obviously relies on both the *Lackawanna* and *Southern Railway* cases, both of which he cites. It is obvious that the very authority upon which the trustee relies recognizes that what comes within the six months' rule depends on the specific facts of each case, and that what might definitely be deemed as repairs or materials and within the rule in a large railway line might properly be deemed reconstruction or new construction in a small one.

The following statement in 2 Gerdes on Corporate Reorganization (p. 1071, par. 673) is most significant. He states in part:

> "Such necessary operating expenses as will be allowed include claims for fuel and power, and other mere incidental *equipment* used in the ordinary course of continuing business, and which would have been paid out of current earnings at the time agreed on if the company had remained in possession.'" (Emphasis supplied)

It will be noted that Gerdes in the passage above quoted uses the phrase, "and other mere *incidental equipment*", as coming within the scope of the six months' rule. This passage clearly shows what the courts mean when they include "equipment" as coming within the rule. They are not referring to extensions of lines or, generally speaking, to basic equipment such as railroad cars, locomotives, etc.; they refer, as Gerdes states, to "incidental equipment." What would be deemed equipment in one case is not equipment in another.

The case of *Rodger Ballast Car Co.* v. *Omaha K.C. & E.R. Co.*, 154 F. 629, cited on page 7 of the trustee's brief, involved the purchase of 32 ballast cars for a railroad employing only 168 miles of railroad. The Court held that this was not a current expense in the ordinary course of business (p. 633). There is no similarity between the purchase of a large number of new cars for a small railroad and the case at bar which involves fare boxes—physically a small part of a bus.

The trustee now argues that the purchase of new boxes by Surface was extraordinary and, therefore, the claim is not entitled to priority. He *ignores his express stipulation* that the new boxes "were intended for and were used in the *ordinary* operations of the Debtor and Surface" (Emphasis supplied) (12a*).

In *Crane* v. *Fidelity Trust Co.*, 238 Fed. 693, cited by the trustee at pages 8-9, the Court granted priority with respect to that portion of the claim which arose within six months of the receivership, but denied it with respect to other claims. The other claims included:

1. Service extensions such as gas equipment for service connection and water equipment for service connections;

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* Figures in parentheses refer to pages of the printed Appendix to appellant's brief in the United States Court of Appeals.

2. main extensions for water main extensions to different places;

3. Betterments such as hydrant systems, wood gates and water valves;

4. reconstruction of water mains and pipes to replace certain old mains;

5. repairs, miscellaneous items in the way of water equipment.

It is important to note, as the Court stated in the *Crane* case, that the items with respect to which priority was denied were sold "*prior to the time preceding the appointment of a Receiver within which courts of equity have announced that priority claims would accrue*" (p. 698).

POINT IV

The six months' rule is a recognized exception to the "absolute priority" which mortgagees would otherwise enjoy.

In this proceeding, the petitioner Johnson is not invoking any novel doctrine. As the trustee himself concedes, the six months' priority rule is of long standing, having had its origin in the opinion of this Court in *Fosdick* v. *Schall, supra,* in 1879. The principal considerations underlying the rule are that:

(1) "Every railroad mortgagee in accepting his security impliedly agrees that the current debts made in the ordinary course of business shall be paid from the current receipts before he has any claim upon the income." (*Southern Railway Co.* v. *Carnegie Steel Co., supra,* at page 274); and

(2) "The maintenance of the road and the prosecution of its business were essential to the preserva-

tion of the security of the bondholders." (*Southern Railway Co.* v. *Carnegie Steel Co., supra* at page 278.)

The case of *Kneeland* v. *American Loan Co.*, 136 U. S. 89, referred to at page 11 of the trustee's answering brief, and the very language quoted in the brief, was considered by this Court in the *Southern Railway Co.* case, but the Court then proceeded to grant priority, recognizing that the claim under consideration came within the six months' rule.

As we have demonstrated in the Petition, the claim in the case at bar likewise falls squarely within the principles laid down for priority under the rule.

CONCLUSION

The petition for a writ of certiorari should be granted.

JOSEPH LORENZ,
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June 24, 1958